



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **201350043**
Release Date: 12/13/2013

Date: September 17, 2013

UIL: 501.33-01

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Karen Schiller
Acting Director, Exempt Organizations
Rulings and Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: July 29, 2013

UIL: 501.33-01

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

Hospital =
State =
Date =
City =
Founder =
Doctor =
Specialty =
Attorney =
=
\$x =
\$y =
LLC =
LLC2 =
Letter1 =
Letter2 =
Letter3 =
PLLC =
Firm =

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code ("Code") § 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under § 501(c)(3). The basis for our conclusion is set forth below.

FACTS:

You were incorporated as a nonprofit corporation under State law. You filed a Form 1023 seeking exemption from federal taxation under § 501(c)(3). Your Articles of Incorporation state that your purpose is:

[T]o protect and enhance the abilities of rural hospitals and healthcare providers to serve the healthcare needs of rural and underserved communities.

You amended your Articles to include the following:

The Corporation is organized exclusively for charitable purposes under section 501(c)(3) of the Internal Revenue Code of 1986, as amended, or corresponding section of any future tax code.

In your Form 1023 materials, you state that you have three members of your board of directors, none of whom resided in State. According to your Bylaws, your members serve four year terms without term limitations. Further, "the successors to those Directors whose terms of office expire shall be elected each year by the remaining directors." Since your initial application materials, you have increased to a five member board of directors, including Attorney, your CEO, and one non-voting member. The non-voting member of your board, Doctor, provides medical services to you on an independent contractor basis. He is also closely related to Attorney.

You state in your Form 1023, your purpose includes providing hospital care to rural communities. In furtherance of this purpose, your primary goal is to create a network of facilities with shared management and resources. You will develop relationships between hospitals and healthcare providers and with other physicians and groups to enable physicians to be able to develop medical specialty service lines at member hospitals. You state that these specialty services will improve the quality of care and increase the reimbursements available to your hospitals which will help to ensure their sustainability. You also state that you will provide and expand transportation services to improve access to care by rural patients. You plan to organize and conduct training and education for physicians, staff, and third parties who will perform specialty procedures. In addition, you state that the development of the specialty lines of services at the member hospitals will create economic benefits to the surrounding communities.

You initially state that you plan to accomplish these goals by acquiring and purchasing Hospital, a ~~##~~ bed critical access hospital, as well as expanding to additional healthcare facilities. Hospital received a determination letter of § 501(c)(3) status on Date. You will expand and renovate Hospital's surgical services by adding a second operating room. You state that a substantial portion of the healthcare market you serve is presently controlled by out-of-state healthcare businesses and these businesses funnel assets and charitable funds out of State. By purchasing and operating Hospital, you will be keeping this hospital locally owned and operated and thus further supporting the rural community.

You state that as sole member of LLC, you entered into an asset purchase agreement to purchase and operate Hospital. You provided a copy of an executed asset purchase agreement between LLC and Hospital, along with a copy of a check for \$x payable to Hospital signed by Founder. However, in subsequent documents, you state that the above LLC does not nor did it ever exist.

Letter1 states that rather than following through with the asset purchase agreement to acquire Hospital, you and Hospital settled on a "change of control" model. There are no written

agreements between you and Hospital describing this change in control model. Under this model, Hospital will retain all assets, including real estate and the State license. In Letter1, you state that you also control all seats on the board of Hospital. You further amended the corporate structure in Letter2, where Hospital amended its Articles of Incorporation to become incorporated as a directorship. You explained in Letter3, that a directorship is "a nonprofit corporate structure in which the board of directors exclusively retains power and control over the corporation, and members if any, have no voting power or control." In this same letter, you further explain that Hospital is now a membership organization with you as the sole corporate member. As a result of this change of control and further changes to incorporation, you assumed control of all of the seats of Hospital's board of directors.

Before you assumed control of the board of directors, Hospital had a fifteen member community represented board. Members of the board included individuals from the farming community, local business community, and a physician, all of whom primarily resided within the community Hospital serves. As you state in Letter 3, Hospital's Bylaws now provide that all Hospital directors shall be appointed exclusively by you and serve at your discretion. You fill any vacancies on Hospital's board.

You maintain that you are not operating Hospital, but are merely a corporate member in the organization. To this effect, you submitted in Letter3 updated and amended Bylaws and Articles of Incorporation for both you and Hospital. Hospital's amended Bylaws state that their purpose "shall be consistent with and supportive of the corporate purposes of [you]." Hospital will support institutions sponsored by you. You also state that since you are no longer operating Hospital nor do you have any plans of operating a hospital in the future, you need not answer the questions pertaining to the requirements of any provisions dealing specifically with hospitals.

You entered into an agreement with Hospital to provide consulting and management services. This agreement includes the payment of a management fee. The fee consists of payment for the services you provide, costs you incur, and monies you have advanced in addition to a fixed monthly fee.

You will utilize Hospital as the base of your operations. You do not have any agreements with other hospitals or physicians at this time. You state that due to your proximity to City (not located in State), you will be able market your services to individuals, physicians, and others who come to City. You will maintain activities in City and eventually may open a satellite office in City.

In addition, you state you will create a network of facilities to provide the level and quality of services at major urban hospitals. One of the ways you will create this network is by developing specialty medicine service lines. By developing the facility and recruitment of physicians who practice in areas such as Specialty, you contend that the result will be an economic increase to the hospitals and the communities they serve. You contend that people will travel to Hospital to receive specialty services and this in turn will increase the amount of resources available for Hospital to treat and serve the entire community.

You will continue to seek out and attempt to attract highly regarded specialty physicians to become co-managers of service lines and or medical directors of the hospitals in your network.

Your goal is to help rural hospitals generate revenue based upon these specialty lines of service.

One of the lines of services that you intend to develop at Hospital is Specialty. In order to accomplish this goal, you will be working with PLLC and Firm. Principal members of these organizations have previous as well as current working and personal relationships. Doctor provides Specialty services and owns PLLC. Hospital has entered into a lease with PLLC to lease medical equipment from PLLC. The assessment of fair market value for the lease was taken from PLLC's representations and the comparison of other quotes for this equipment.

Firm, where Attorney works, has been selected to provide legal counsel at a fair market value for legal services. You state you have paid Firm \$y for legal services rendered. There was no written agreement or contract between you and Attorney or Firm. You state that you intended to create a contract for services in the near future. In subsequent follow up, you state that neither you nor Hospital has ever done any business with Firm. You acknowledge that Attorney has worked on legal and regulatory matters on your behalf.

Attorney and Founder started a business of LLC2 whose primary purpose was to provide healthcare business consulting services to healthcare professionals. PLLC has used the services of LLC2 to provide consulting services to their practice. You have stated that you plan to specifically prohibit your organization from doing any business with LLC2. Furthermore, LLC2 is in the process of winding up and will no longer be providing services to anyone. Upon further development regarding these relationships from this office, you state in Letter3 that Firm does not exist and there is no relationship between you and Firm.

LAW

Section 501(c)(3) provides that an organization may be exempted from tax if it is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes and "no part of the net earnings of which inures to the benefit of any private shareholder or individual...."

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt under § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the exempt purposes specified in that section. If an organization fails to meet either the organizational test or the operational test, it does not qualify for exemption.

Section 1.501(a)(1)-1(c) defines a "private shareholder or individuals" as "persons having a personal and private interest in the activities of the organization." Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will

not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) provides that "[a]n organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals...."

Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. To meet the requirement of this subsection, the burden of proof is on the organization to show that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) states, in part, that the term "charitable" in § 501(c)(3) includes relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; lessening of the burdens of government; and promotion of social welfare by organizations designed to accomplish any of the above purposes.

Section 1.501(c)(3)-1(d)(3)(i) states that the term "educational" in § 501(c)(3) includes the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e)(1) provides that an organization may meet the requirements of § 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in § 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under § 501(c)(3).

Rev. Rul. 69-545, 1969-2 C.B. 117, recognizes that the promotion of health, in and of itself, can be a charitable purpose, at least where the community as a whole is benefitted. In explaining why an explicit level of charity care is not required, the ruling states that the "promotion of health...is deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community, such as indigent members of the community, provided that the class is not so small that its relief is not of benefit to the community."

Rev. Rul. 71-529, 1971 C.B. 234, describes a nonprofit organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds. Because the organization is performing an essential function for tax-exempt organizations for a charge "substantially below cost," it qualifies for exemption under § 501(c)(3).

Rev. Rul. 72-369, 1972-2 C.B. 245, concerns an organization formed to provide managerial and consulting services to unrelated § 501(c)(3) organizations. The organization enters into

agreements with unrelated nonprofit organizations to furnish managerial and consulting services on a cost basis. The ruling states that providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of § 501(c)(3). Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable. Accordingly, the ruling holds that the organization's activities are not charitable and, consequently, the organization does not qualify for exemption under § 501(c)(3).

Rev. Rul. 73-313, 1973-2 C.B. 174, held that attracting a physician to a community having no available medical services furthered the charitable purpose of promoting the health of the community. In the ruling, residents of an isolated rural community had to travel a considerable distance to obtain care. Faced with the total lack of local services, the community formed an organization to raise funds and build a medical office building to attract a doctor to the locality. The ruling stated certain facts are particularly relevant: (1) the demonstrated need for a physician to avert a real and substantial threat to the community; (2) evidence that the lack of a suitable office had impeded efforts to attract a physician; (3) the arrangements were completely at arm's-length; and (4) there was no relationship between any person connected with the organization and the recruited physician. The ruling said the arrangement used to induce the doctor to locate a practice in the area bears a reasonable relationship to promotion and protection of the health of the community and any private benefit to the physician is incidental to the public purpose achieved. It concluded the activity furthers a charitable purpose and the organization qualified for § 501(c)(3) exemption.

Rev. Rul. 76-419, 1976-2 C.B. 146, held that a nonprofit organization that purchased blighted land in an economically depressed community, converted the land into an industrial park, and induced industrial enterprises to locate new facilities in the park through favorable lease terms that required employment and training opportunities for unemployed and underemployed residents in the area, is operated exclusively for charitable purposes.

Rev. Rul. 77-111, 1977-1 C.B. 144, held that an organization formed to increase business patronage in a deteriorated area by providing information about the shopping opportunities is not operated for charitable purposes and is not exempt under § 501(c)(3). Increasing business patronage and reviving lagging sales are not charitable purposes.

Rev. Rul. 77-69, 1977-1 C.B. 143, describes an agency that was organized and operated pursuant to federal statute to establish and maintain a system of health planning and resource development aimed at providing adequate health care for a specified geographic area. It was funded by federal grants and managed by government officials and members of the public. The organization gathered and analyzed health data, established health system plans and goals, coordinated activities with professional standards review organizations, reviewed and approved grant applications for federal funds, and assisted states in reviewing health services capital expenditures. The organization promoted the health of the residents of the area in which it functioned, and met the requirements of lessening the burdens of government, and therefore operated for charitable purposes under § 501(c)(3).

Rev. Rul. 80-287, 1980-2 C.B. 195, provides that a nonprofit lawyer referral service does not qualify for exemption under § 501(c)(3). The organization aided persons who did not have an attorney by helping them select one, in exchange for a nominal service charge. Any attorney who was a member of a local bar association could apply for placement on the referral list, in exchange for an application fee. Because a substantial purpose of the organization was aiding the legal profession, the organization was not organized or operated exclusively for charitable purposes, even though its lawyer referral service did provide some public benefit.

Rev. Rul. 81-276, 1981-2 C.B. 128, describes a professional standards review organization established pursuant to a federal statute to review health care practitioners' and institutions' provision of health care services and items for which payment is made under Medicare and Medicaid, and determine whether the quality of services met professionally recognized standards of care. The IRS ruled that by taking on the government's burden of reviewing the quality of services under Medicare and Medicaid, the organization lessened the burdens of government within the meaning of § 1.501(c)(3)-1(d)(2). Any benefit to members of the medical profession from such activities was incidental to the benefit the organization provided in lessening the burdens of government. Therefore, the organization qualified for exemption under § 501(c)(3).

Rev. Rul. 85-110, 1985-2 C.B. 166, holds that the performance of diagnostic laboratory testing on referred specimens from private patients of hospital staff physicians, by a hospital exempt under § 501(c)(3), is unrelated trade or business if such services are otherwise available in the community.

Rev. Rul. 97-21, 1997-1 C.B. 121, involved various "situations" in which incentives were used to recruit private practice physicians to join a hospital's medical staff or to provide medical services in the community. Situation 1 involved Hospital A, located in rural County V, which was the only hospital within a 100-mile radius. The U.S. Public Health Service designated County V as a Health Professional Shortage Area for primary medical care professionals. Hospital A recruited physician M to establish and maintain a full-time private OB/GYN practice in its service area and become a member of its medical staff. The ruling held Situation 1 did not affect Hospital A's exempt status and, like the organization described in Rev. Rul. 73-313, Hospital A had objective evidence demonstrating a need for obstetricians and gynecologists in its service area and engaged in physician recruitment activity bearing a reasonable relationship to promoting and protecting the health of the community in accordance with Rev. Rul. 69-545.

In Rev. Rul. 98-15, 1998-1 C.B. 718, the IRS noted that "not every activity that promotes health supports tax exemption under section 501(c)(3). For example, selling prescription pharmaceuticals certainly promotes health, but pharmacies cannot qualify for recognition of exemption under [section] 501(c)(3) on that basis alone."

In Better Business Bureau of Washington D.C., Inc. v. U.S., 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that a trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university, and therefore, the association did not qualify for exemption.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court considered an organization that provided consulting services to groups that were mostly § 501(c)(3) organizations. The organization charged fees for its services set at or close to its own cost. The court concluded that there was nothing to distinguish these activities from those of an ordinary commercial consulting enterprise, and affirmed the Service's denial of exemption under § 501(c)(3).

In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), *aff'd*, 625 F.2d 804 (8th Cir. 1980), the court held that, while selling prescription pharmaceuticals to elderly persons at a discount promotes health, the pharmacy did not qualify for recognition of exemption under § 501(c)(3) on that basis alone. Because the pharmacy operated for a substantial commercial purpose, it did not qualify for exemption under § 501(c)(3).

IHC Health Plans, Inc. v. Commissioner, 325 F.3d 1188 (10th Cir. 2003), involved an operator of health maintenance organizations ("HMOs") that served approximately one-quarter of Utah's residents and approximately one-half of its Medicaid population. The court held that the organization failed to meet the community benefit standard to qualify for exemption under § 501(c)(3) because its sole activity was arranging for health care services for its members, in exchange for a fee. The court said that providing health-care products or services to all in the community is necessary but not sufficient to meet the community benefit standard. Rather, the organization must provide some additional benefit that likely would not be provided in the community but for the tax exemption, and that this public benefit must be the primary purpose for which the organization operates.

In Harding Hospital, Inc., 505 F.2d 1068 (6th Cir. 1974), the court denied exempt status under § 501(c)(3) to a non-profit hospital due to a contract that the hospital entered into with a partnership composed of physicians. The contract gave the physicians control over care of the hospital's patients and the stream of income generated by the patients while also guaranteeing the physicians thousands of dollars in payment for various supervisory activities. The Court concluded by holding that the benefits derived from the contract constituted sufficient private benefit to preclude exemption.

In Geisinger Health Plan v. Commissioner, 985 F.2d 1210 (3rd Cir. 1993), the court held that a pre-paid health care organization that arranged for the provision of health care services only for its members, benefited its members, not the community as a whole and therefore did not further charitable purposes within the meaning of § 501(c)(3).

In Church by Mail v. Commissioner, 765 F.2d 1387, 1392 (9th Cir. 1985), the court in determining that a non-profit was operated for substantial non-exempt purposes and that income inured to the benefit of private persons stated that "[t]he critical inquiry is not whether particular...payments to a related for-profit organization are reasonable or excessive, but whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the [non-profit]." The court additionally upheld the Tax Court's determination that the church was operated for substantial nonexempt purpose of providing a market for services of advertising agency, a for-profit organization owned and controlled by ministers of church.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C. 2003), the court concluded that an organization did not qualify for tax-exemption under § 501(c)(3) because it was operated for nonexempt commercial purposes rather than for exempt purposes. Among the major factors the court considered in reaching this conclusion was the organization's competition with for-profit commercial entities, the extent and degree of below cost services provided, the pricing policies, and the reasonableness of financial reserves. Additional factors included whether the organization used commercial promotional methods, such as advertising, and the extent to which the organization received charitable donations.

The Tax Court has stated that an application for tax-exempt status "calls for open and candid disclosure of all facts bearing upon [an Applicant's] organization, operations, and finances to assure [that there is not] abuse of the revenue laws. If such disclosure is not made, the logical inference is that the facts, if disclosed, would show that the [Applicant] fails to meet the requirements of section 501(c)(3)." Bubbling Well Church of Universal Love, Inc. v. Comm'r, 74 T.C. 531 (1980). See also, Founding Church of Scientology v. United States, 188 Ct. Cl. 490, 498, 412 F.2d 1197, 1201 (1969), cert. denied, 397 U.S. 1009 (1970). Furthermore, the courts have repeatedly upheld the Service's determination that an organization has failed to establish exemption where the organization fails to provide requested information. "[Applicant] has, for the most part, provided only generalizations in response to repeated requests by [the Service] for more detail on prospective activities....Such generalizations do not satisfy us that [applicant] qualifies for the exemption." Peoples Prize v. Comm'r, T.C. Memo 2004-12 (2004).

Analysis

To satisfy the operational test under § 1.501(c)(3)-1(c)(1), an organization must establish that it is operated exclusively for one or more exempt purposes. An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in § 501(c)(3). Under the operational test, the purpose towards which an organization's activities are directed, and not the nature of the activities themselves, is ultimately dispositive of the organization's right to be classified as a § 501(c)(3) organization. B.S.W. Group, supra. Your activities are not directed toward one or more exempt purposes.

Promotion of Health

The promotion of health has long been recognized as a charitable purpose under common law. However, not every activity that generally promotes health furthers exclusively charitable purposes under § 501(c)(3). For example, selling prescription pharmaceuticals promotes health, but pharmacies cannot qualify for recognition of exemption under § 501(c)(3) on that basis alone. Federation Pharmacy Services, Inc, supra. Nor does a hospital primarily further a charitable purpose solely by offering health care services to the public in exchange for a fee. See Rev. Rul. 69-545, supra. Rather, a hospital must be organized and operated primarily for the benefit of the community, as evidenced by such factors as a board that represents the community, operation of an emergency room, provision of charity care, medical training, or medical research. For example, a health maintenance organization that is operated primarily for the purpose of benefiting its paying subscribers does not qualify for exemption solely because

the community also derives health benefits from its activities. See Geisinger Health Plan, supra; and IHC Health Plans, Inc., supra.

You do not provide healthcare services directly to patients, unlike the hospital in Rev. Rul. 69-545. Your activities consist of the provision of management services, sharing of medical equipment, and developing specialty lines of services.

While your activities are related to providing health care, providing management and consulting services focusing on developing new and more lucrative lines of medical treatment does not promote health or benefit the community in a charitable manner. While a hospital does not primarily further a charitable purpose simply by offering health care services to the public in exchange for a fee, similarly providing health care-related management and consulting services and equipment sharing in a commercial manner does not further charitable purposes. See Rev. Rul. 69-545, supra, Rev. Rul. 77-111, supra. Also, as the court noted in IHC Health Plans, Inc., supra at 1197:

In giving form to the community-benefit standard, we stress that 'not every activity that promotes health supports tax exemption under § 501(c)(3). For example, selling prescription pharmaceuticals certainly promotes health, but pharmacies cannot qualify for . . . exemption under § 501(c)(3) on that basis alone.' Rev. Rul. 98-15. In other words, engaging in an activity that promotes health, *standing alone*, offers an insufficient indicium of an organization's purpose. Numerous for-profit enterprises offer products or services that promote health.

In several revenue rulings, the Internal Revenue Service concluded that an organization was promoting health within the meaning of § 501(c)(3) even though it was not directly providing medical care to patients because it improved the effectiveness of health care provided by others. See Rev. Rul. 77-69, supra; and Rev. Rul. 81-276, supra. However, the organizations in these revenue rulings were created pursuant to federal statutes and worked closely with the government to support its health care responsibilities. You were not established pursuant to any federal statute and no government agency supports your activities, and as such you are not like the organizations described in the above-referenced rulings.

In some instances, incentivizing physicians to practice in rural areas can promote the health of a community. See Rev. Rul. 97-21, supra and Rev. Rul. 73-313, supra. However, the organization in Situation 1 of Rev. Rul. 97-21 recruited a physician based on objective evidence demonstrating for a need for a particular practice in the organization's service area and engaged in recruitment activity bearing a reasonable relationship to promoting and protecting the health of the community in accordance with Rev. Rul. 69-545. You have not provided any evidence indicating that your contemplated specialty services are needed in Hospital's community. Also, you are unlike the charitable organization in Rev. Rul. 73-313 in two primary ways. First, you were not formed to assist an isolated rural community without access to any medical services. Prior to your involvement, Hospital received exemption under § 501(c)(3) on Date, and you indicate it has operated continuously in the community since that time. Second, there are multiple relationships between you and at least one of your board members and

connected physicians. Attorney and Doctor have a family relationship, and you indicate that Doctor will serve to develop Specialty at Hospital.

Therefore, although some of your activities may indirectly promote health in a general sense, they do not primarily promote health in a charitable manner within the meaning of § 501(c)(3) and § 1.501(c)(3)-1(d)(2).

Education

Furthering education is an exempt purpose within the meaning of § 501(c)(3). See § 1.501(c)(3)-1(d)(3). The regulations explain that the term "educational" in § 501(c)(3) includes the instruction of the public on subjects useful to the individual and beneficial to the community. See § 1.501(c)(3)-1(d)(3)(i).

While you state you plan to organize and conduct training and education for physicians, staff, and third parties who will perform specialty procedures, these educational activities only benefit your affiliated physicians for use in their private businesses and your management consulting clients. You will not be providing educational services to individuals or to the community. Your activities will not constitute instructing the public on subjects that are beneficial to the community within the meaning of § 1.501(c)(3)-1(d)(3). Therefore, your primary activities do not further education within the meaning of § 1.501(c)(3)-1(d)(3).

Combating Community Deterioration

Combating community deterioration is an exempt purpose within the meaning of § 501(c)(3). See § 1.501(c)(3)-1(d)(2)(iv). Organizations combating community deterioration in a charitable manner provide economic development activities in which the good received by the general public outweighs the private benefit afforded to the beneficiaries.

Rev. Rul. 76-419, supra deals with an organization that purchases land in a blighted area and converts it into an industrial park. Lots are leased at favorable rates to industrial tenants. These enterprises are required to hire and train people from this economically depressed area. By inducing industry to locate in an economically depressed area and hire the unemployed, the organization benefits the community.

Unlike the organization described in Rev. Rul. 76-419, supra, you are not created with the specific intent to revitalize the neighboring areas and hiring and training people from the area. You are intended to recruit specialty physicians from outside the area to bring them to Hospital to expand the specialty lines at Hospital. Although you claim the activity will bring economic benefit to the Hospital community, the economic benefits from the recruitment of the specialty physicians to develop specialty services will primarily benefit the physicians themselves and Hospital far more than the surrounding areas.

Rev. Rul. 77-111, supra demonstrates that even though an organization's activities may contribute to the achievement of charitable purposes the facts may show that the overall thrust and end result would be the achievement of non-exempt purposes, the benefit of private individuals or businesses. The organization was formed to increase business patronage in a

deteriorated area by providing information about shopping opportunities is not operated for charitable purposes. Increasing business patronage and reviving lagging sales are not charitable purposes. Much like the organization described in Rev. Rul. 77-111, supra you are primarily established to increase revenue for and Hospital and the specialty physicians.

Because the private benefits outweigh any charitable purposes, your primary activities do not combat community deterioration within the meaning of § 1.503(c)(3)-1(d)(2)(iv).

Substantial Non-Exempt Purpose

An organization is operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. See § 1.501(c)(3)-1(c)(1).

Providing services of an ordinary commercial nature, regardless of whether the undertaking is conducted on a nonprofit basis and is beneficial to the community, does not further a charitable purpose, unless the service directly accomplishes a tax-exempt purpose. See Rev. Rul. 80-287, supra. The sale of health-related goods and services (e.g., laboratory services, pharmaceuticals, HMO services, consulting services) does not exclusively further charitable purposes because such activities serve a substantial non-exempt, commercial purpose. See, e.g., Federation Pharmacy Services, supra (sale of pharmaceuticals to senior citizens was presumptively commercial, because such activity was normally pursued by commercial enterprises); Rev. Rul. 85-110, supra (exempt hospital's provision of laboratory testing services to non-patients served non-charitable purposes).

You are established to provide fee-based consulting and management services to hospitals and networks of healthcare providers. These types of services are commercial in nature rather than charitable. Your activities of providing management, advisory, and consulting services in return for a fee to member hospitals does not constitute an exempt activity. See B.S.W. Group, Inc., supra.

The activities you perform are more akin to those of a trade or business that is ordinarily carried on by for-profit commercial organizations. In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C 2003) the court relied on the "commerciality" doctrine in determining whether an organization was operated for exempt purposes. The Court in Airlie concluded that the organization was operated for a non-exempt commercial purpose because of the commercial manner in which the organization conducted its activities.

Like the organizations in Airlie and B.S.W. Group, you are not organized for an exempt purpose. Rather, you are operated for a nonexempt commercial purpose; your management services agreement recovers costs plus fees for the services rendered.

You are managed by your board of directors, several of whom have substantial ties to the financial success of Hospital. In addition to facilitating the physician-led development of specialty medical services, you will provide to Hospital and your other member organizations services such as: management, administrative, and business services as necessary, provide or

finance medically related equipment as required by Hospital, assist Hospital with the establishment and implementation of procedures, advise Hospital on contractual arrangements with third parties, maintain and establish billings and collections policies for Hospital, and other consulting services.

Thus, your activities are not inherently charitable but are more like activities carried on by for-profit businesses, a factor that supports the commercial nature of your activities. See, e.g., Living Faith, Inc., supra (organization's health food stores and restaurants were in competition with for-profit organizations); and IHC Health Plans, supra (health plans resembled and competed with commercial insurance providers). Because your primary activities are providing consulting services in the manner of a commercial business (as nearly all of your activities are focused on increasing revenues for your physicians and network members), your activities serve a substantial non-exempt purpose under § 1.501(c)(3)-1(c)(1).

The provision of commercial services may serve primarily charitable purposes when those services are provided exclusively to tax-exempt organizations, are an essential function of such organizations, and are provided for a fee that is substantially below cost. See Rev. Rul. 71-529 (an organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualifies for exemption under § 501(c)(3)), supra; and Rev. Rul. 72-369 (an organization that provides managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under § 501(c)(3)), supra. While Hospital and other potential new members may be exempt under § 501(c)(3), you are like the non-exempt organization in Rev. Rul. 72-369. In fact, you require your members to pay cost plus an additional fee for your managerial and consulting services.

Any charitable or educational benefits the public may derive from your consulting and managerial services are merely incidental to your principal purpose of increasing your members' revenue and benefiting your board of directors and specialty physicians. Thus, your activities do not primarily further an exempt purpose. Therefore, you are not "operated exclusively" for one more exempt purpose under § 501(c)(3). See § 1.501(c)(3)-1(c)(1) (an organization will not be regarded as "operated exclusively" for one or more exempt purposes under § 501(c)(3) if more than an insubstantial part of its activities is not in furtherance of an exempt purpose). Better Business Bureau of Washington D.C., Inc., supra.

Private Benefit

Organizations seeking exemption under § 501(c)(3) must be organized and operated exclusively for exempt purposes pursuant to § 1.501(c)(3)-1(a). An entity that is organized or operated to serve private rather than public interests cannot be recognized as operating exclusively for exempt purposes. See § 1.501(c)(3)-1(d)(1)(ii) and American Campaign Academy, supra. The Tax Court explained that prohibited private benefits may include an "advantage, profit, fruit, privilege, gain, or interest." See American Campaign Academy, at 1065. In determining whether an organization's activities confer an impermissible private benefit, the court in American Campaign Academy, supra, looked to whether the beneficiaries of the organization's activities are also the parties who founded, fund, and direct the organization.

Your proposed activities are presumably intended to promote the health through increased member revenues, and by extension, increased revenues for you physician co-managers. However, not every activity that promotes health supports tax exemption under § 501(c)(3); "an institution for the promotion of health is not a charitable institution if it is privately owned and is run for the profit of the owners." 4A Austin W. Scott and William F. Fratcher, the Law of Trusts § 372.1 (4th ed. 1989). See also *Restatement (Second) of Trusts*, § 376 (1959). As currently structured, your activities are primarily beneficial to your members' physicians and co-managers because you are focused on maximizing their collective revenue streams in their private businesses. Although you assert that keeping your rural members' medical centers as "locally owned and operated," your activities primarily benefit the physician co-managers by allowing such individuals to develop specialty lines of practice with maximum profit as the end goal, not ensuring sufficient medical treatment for the benefit of the entire community as contemplated by Rev. Rul. 69-545. See also Harding Hospital, *supra*.

In addition, your board of directors is self-perpetuating and composed of five persons, many of whom have personal and business relationships. Three of your directors have previous business relationships and one, Doctor, stands to directly benefit from any additional revenues brought in to Hospital. The fact that your board lacks public participation of any kind indicates that you are operated for the benefit of your directors rather than the public. Because your operations substantially benefit your directors, you have not demonstrated that your operations serve a public rather than a private interest as required under § 1.501(c)(3)-1(d)(1)(ii). See also Better Business Bureau of Washington D.C., Inc., *supra*, and Church by Mail, Inc., *supra*.

Inurement

Organizations seeking exemption under § 501(c)(3) are also subject to the inurement provision contained in § 1.501(c)(3)-1(c)(2), which states that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals (often referred to as "insiders"). The inurement proscription applies to persons who because of their particular relationship with an organization have an opportunity to control or influence its activities. You have on your board a physician, Doctor, who works in Specialty at Hospital. One of your primary business models is that by the development of specialty service lines at rural hospitals, you will derive more revenues for the hospitals and participating physicians. These physicians are insiders because they are in a position to have control over your activities through participation in and influence over the board of directors and your activities.

The taxpayer must also demonstrate that it is organized and operated exclusively for exempt purposes and that no part of its earnings inures to private individuals. You appear to operate for the benefit of some of your officers and directors. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Your primary purpose is providing managerial and consulting services for a fee for Hospital with the goal of increasing its revenues, including revenues to your specialty physician co-managers, including Doctor. In addition, you have provided conflicting information regarding your business relationships with Attorney and Firm.

The burden is on the taxpayer to demonstrate that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, the shareholders of

the organizations, or persons controlled, directly or indirectly, by such private interests, and will not allow its assets to inure to such private interests. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii); see also Church of Spiritual Technology, 18 Cl.Ct. at 250 (the applicant "must put into the record sufficient materials to warrant the grant of tax exempt status."); Bubbling Well Church of Universal Love, 74 T.C. 531 (stating that an application for tax-exempt status "calls for open and candid disclosure of all facts . . . If such disclosure is not made, the logical inference is that the facts, if disclosed, would show that the [Applicant] fails to meet the requirements of section 501(c)(3).") Any gaps contained in the administrative record are resolved in favor of the Service. New Dynamics Foundation, 70 Fed. Cl. at 802 ("in initial qualification cases such as this, gaps in the administrative record are resolved against the applicant").

CONCLUSION:

Based on the information provided in your Form 1023 and supporting documentation, we conclude that you are not operated exclusively for purposes described in § 501(c)(3).

Accordingly, you do not qualify for exemption as an organization described in § 501(c)(3) and you must file federal income tax returns.

Contributions to you are not deductible under § 170.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code § 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for

the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service

1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Karen Schiller
Acting Director, Rulings and Agreements